

INITIAL STATEMENT OF REASONS FOR THE  
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,  
TITLE 18, SECTION 25113, AND AMENDMENT OF  
CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25111

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR  
CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS

The proposed regulation is intended to provide guidance concerning the statutory water's-edge election provisions. The prior method of making a water's-edge election involved taxpayers entering into a contract. The proposed new regulation will provide examples of the new rules involved with making the statutory election, and the existing regulation will be amended to reflect statutory changes.

SPECIFIC PURPOSE OF THE REGULATIONS

This proposed new regulation would provide detailed guidance and rules relating to making and terminating water's-edge elections, as well as definitions of terms used in the statute. In general, this regulation addresses situations wherein questions may arise as to the validity of a water's-edge election or ability of taxpayers to terminate an election.

In addition, Revenue and Taxation Code sections 25111 and 25113 both provide that taxpayers that have a valid election for taxable years beginning before January 1, 2003 will continue to file on a water's-edge basis and will be deemed to have elected under the new rules for taxable years beginning on or after January 1, 2003. However, the election commencement date under the new rules of Revenue and Taxation Code section 25113 will continue to be the start date as originally elected under the old rules of Revenue and Taxation Code 25111. Regulation section 25111 is proposed to be amended to reflect this statutory change.

NECESSITY

Currently the Franchise Tax Board does not have a regulation providing guidance and examples regarding the new statutory water's-edge election under Revenue and Taxation Code section 25113. An FTB Notice (2004-2) was issued when the new statute was enacted to provide guidance in the form of examples of the transition rules from the old water's-edge contract to the new statutory election. However, this FTB Notice is not comprehensive in providing guidance for all of the rules set forth under the statutory election, and implementing regulations are thus necessary.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS.

The Franchise Tax Board examined and considered the regulatory history of Cal. Code of Regs., title 18, section 25111, including notices, statements of reasons, public hearing documents, written comments and responses thereto, the legislative history of both

Revenue and Taxation Code sections 25111 and 25113, and FTB Notice 2004-2. Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

#### ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS.

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed regulation section 25113 and amendment to regulation section 25111 or would be as effective and less burdensome to affected private persons or small businesses than the proposed regulation and amendment. In addition, the proposed regulation and amendment pertain to corporate taxpayers and therefore does not affect private individuals.

#### ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that proposed amendment to regulation section 25111 and proposed regulation section 25113 of the California Code of Regulations will not have a significant overall economic impact on business. The proposed regulation is primarily an explanation of the new and revised statutory language of Revenue and Taxation Code sections 25113 and 25111, respectively, with examples to illustrate application of those sections.